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February 21, 2002

**BY HAND**

Honorable Janet Hand Deixler  
Secretary  
New York State Public Service Commission  
Three Empire State Plaza  
Albany, New York 12223

**Re: Case 00-C-1945**

Dear Secretary Deixler:

Enclosed please find the Reply Brief of Verizon New York Inc. in Support of the Joint Proposal Concerning the Verizon Incentive Plan.

Respectfully submitted,

A handwritten signature in black ink, appearing to read "Sandra Dilorio Thorn".

Sandra Dilorio Thorn

cc: Honorable Jaclyn A. Brilling (By E-mail and Hand)  
Honorable Judith A. Lee (By E-mail and Hand)  
Honorable Joel A. Linsider (By E-mail and Hand)  
Honorable Eleanor Stein (By E-mail and Hand)  
All Active Parties (By E-mail and Overnight Delivery)

**STATE OF NEW YORK  
PUBLIC SERVICE COMMISSION**

**Proceeding on Motion of the  
Commission to Consider Cost Recovery  
by Verizon and to Investigate the Future  
Regulatory Framework**

**Case 00-C-1945**

**REPLY BRIEF OF VERIZON NEW YORK INC.  
IN SUPPORT OF THE JOINT PROPOSAL  
CONCERNING THE VERIZON INCENTIVE PLAN**

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**Dated: February 21, 2002**

## TABLE OF CONTENTS

	<u>Page</u>
<b>I. INTRODUCTION .....</b>	<b>1</b>
<b>II. THE JOINT PROPOSAL.....</b>	<b>3</b>
<b>A. PRICING FLEXIBILITY IS APPROPRIATE.....</b>	<b>5</b>
<b>B. THE SERVICE QUALITY PLAN IS SUFFICIENT TO         PROTECT CONSUMERS .....</b>	<b>8</b>
1. Verizon NY Has Fulfilled the Purpose of the Performance Regulation Plan .....	8
2. The Service Quality Plan Appropriately Measures Service Using Statewide Annual Averages.....	12
3. The Performance Objective Targets Are Appropriate .....	15
4. The Plan's Proposed Penalty Amounts Are Appropriate .....	18
5. There Should Be No Separate Penalties for Individual Outliers .....	20
6. Reviewing Service No Sooner Than The End of the First Plan Year Is Appropriate .....	21
7. The Pricing Flexibility Link to Service Quality Should Not Be Modified.....	23
<b>C. THE TRANSITION TO GAAP ACCOUNTING IS         APPROPRIATE.....</b>	<b>23</b>
<b>III. THE PLAN SHOULD BE VIEWED IN ITS ENTIRETY       AND APPROVED AS SUBMITTED.....</b>	<b>24</b>
<b>A. THE JOINT PROPOSAL DOES NOT BAR VERIZON NY         FROM RECOVERING CERTAIN OSS COSTS .....</b>	<b>24</b>
<b>B. VERIZON NY'S AGREEMENT TO PARTICIPATE ON         TASK FORCES SHOULD NOT BE TRANSFORMED INTO         A MANDATE FOR NEW REGULATION .....</b>	<b>25</b>
<b>C. THE JOINT PROPOSAL APPROPRIATELY ADDRESSES         POSSIBLE REFUNDS ARISING FROM TEMPORARY         SWITCHING RATES .....</b>	<b>27</b>

## TABLE OF CONTENTS

	<u>Page</u>
D. THE COMMISSION SHOULD NOT RESPOND TO UNSUPPORTED ASSERTIONS REGARDING THE LIFELINE PROGRAM .....	28
E. THE COMMISSION SHOULD REJECT CABLEVISION LIGHTPATH'S ATTEMPT TO EVADE ITS STATUTORY OBLIGATION TO NEGOTIATE INTERCONNECTION AGREEMENTS.....	30
F. THERE IS NO NEED TO IMPOSE ADDITIONAL OBLIGATIONS ON VERIZON NY TO KEEP CLECS INFORMED OF NEW TECHNOLOGY AND NEW SERVICES .....	32
G. THE COMMISSION SHOULD NOT MODIFY THE JOINT PROPOSAL TO ADDRESS A GENERAL CONCERN ABOUT THE ABSENCE OF A DIFFUSION FUND REQUIREMENT .....	33
IV. CERTAIN PROVISIONS OF THE JOINT PROPOSAL HAVE BEEN CLARIFIED .....	35
V. CONCLUSION.....	36

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**I. INTRODUCTION**

The Commission should approve the Joint Proposal for the Verizon Incentive Plan (the “Joint Proposal” or “Plan”) without modification. Nearly all of the participants in the negotiations – participants that include Staff and many of Verizon NY’s competitors – have endorsed the Joint Proposal and urge its adoption. Even the Office of the Attorney General (the “AG”), which recommended some modifications to the Joint Proposal, has stated “it’s the best chance we have to go forward and actually create a competitive setting that is in the long-term best interests of ratepayers.”<sup>1</sup> Tr. at 83. In the final analysis, no party – including those seeking clarification or modification of the Joint Proposal – has provided good reason to reject or modify it.

The Joint Proposal, taken as a whole, achieves the appropriate balance among the competing interests of all parties and serves the public interest as well. This is especially true in light of the Commission’s UNE Rate Order which is likely to increase competition

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<sup>1</sup> Transcript of Evidentiary Hearing held February 19, 2002 (“Tr.”), at 83.

in the State.<sup>2</sup> Indeed, for this reason, at the hearing, almost all of the commenters made clear that, notwithstanding any questions they may have raised, their preference is that the Joint Proposal be approved as presented to the Commission and that they address any concerns they have about other issues directly with Verizon NY.

While some parties seek to modify the Joint Proposal or add extraneous provisions, the changes they suggest would unfairly impose additional costly obligations on Verizon NY. Those proposals also fail to take into account the impact on competition in the state, the negative consequences of upsetting the careful balance reflected in the Joint Proposal, or the already substantial concessions Verizon NY made during the course of the negotiations.

As party after party attested at the Commission hearing, the Joint Proposal reflects a balanced, thoughtful regulatory approach, which carefully considered the various interests expressed in settlement discussions. Because the Joint Proposal is the product of lengthy negotiations among numerous parties,<sup>3</sup> it necessarily contains compromises that

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<sup>2</sup> Case 98-C-1357, "Order on Unbundled Network Element Rates," issued and effective January 28, 2002 (the "UNE Rate Order").

<sup>3</sup> Assemblyman Richard Brodsky has expressed concern that the Commission is reaching a decision in this matter in "haste." (Tr. at 115.) This proceeding was hardly conducted in haste. The Joint Proposal is being considered at the end of a process that began on November 3, 2000. On January 2, 2001 – more than one year ago – the Administrative Law Judges (the "ALJs") presiding over this proceeding issued a "Ruling Inviting Comments and Convening Conference on the Scope of the Proceeding." Among other things, that Ruling (which was posted on the Commission's website) invited interested parties to submit "a brief statement of the issues they believe warrant study in this proceeding." On February 13, 2001, the ALJs held a procedural conference at which interested parties offered their views on the type of proceeding to be conducted and the issues to be addressed. Two days later, the ALJs issued a "Ruling on Scope and Schedule" which reflected input received from the parties at the procedural conference (and which was also posted on the Commission's website). Consistent with the schedule set forth in that Ruling, Verizon NY filed its Verizon Incentive Plan for New York on May 15, 2001. That filing received extensive media coverage. Formal settlement discussions were noticed for August. Formal settlement discussions actually began on December 5, 2001. Negotiations proceeded for a full two months and culminated in the filing of the Joint Proposal on February 8, 2002. As discussed herein, the Joint Proposal enjoys the support of virtually all the parties that participated in the proceeding. Given the long  
(continued . . .)

are designed ultimately to balance all parties' interests in a fair and reasonable manner. No party achieved everything it sought, and each party had to make some concessions. Numerous parties testified that they supported accepting the Joint Proposal as submitted because it is a coherent "acceptable negotiated outcome"<sup>4</sup> that "achieves a stable and effectively competitive"<sup>5</sup> market in New York.

Finally, the Joint Proposal reflects the fact, which this Commission long has recognized, that competitive forces rather than regulation can and should be relied on to discipline the market and the industry, and to create better, more targeted, and more flexible incentives for improving service, choice, and prices. The Joint Proposal, as it is currently styled, is an important – and necessary – step forward, as the Commission helps move New York toward an even more robustly competitive telecommunications marketplace that is governed by market forces rather than regulation. Accordingly, the Joint Proposal should be adopted as presented to the Commission.

## **II. THE JOINT PROPOSAL**

As noted, the Joint Proposal is a compromise. It is designed to balance a number of important goals: increasing competition, protecting consumers, and leveling the playing field so that Verizon NY has a fair opportunity to compete and invest in New York. It also is designed specifically to take into account the highly competitive New York market.

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(...continued)

procedural history of this matter, the Commission is well positioned to consider the merits of the Joint Proposal on February 27.

<sup>4</sup> Tr. at 108.

<sup>5</sup> Tr. at 85-86.

As part of that compromise and balance, Verizon NY agreed not to challenge, for the duration of the Plan, the wholesale prices ordered by the Commission in its UNE Rate Order. This promise was made in spite of the fact that these UNE prices constitute a 30% reduction in Verizon NY's wholesale rates. Verizon NY also agreed to far more benefits for wholesale and retail customers, including: expanded offerings of UNE-P for small businesses above and beyond the Federal Communications Commission's ("FCC's") requirements; a \$15 million pool for potential refunds from temporary switching rates for smaller CLECs; credits against the \$185.00 rate for hot cuts (resulting in a \$35.00 per loop non-recurring charge for 2-wire and 4-wire hot cuts); and adherence to a service quality plan with substantial financial penalties for failure to perform (including the suspension of prospective pricing flexibility). In addition, Verizon NY agreed to participate on certain task forces with other carriers to further promote competition and collaboration through the development of best practices for the industry.

In return, Verizon NY received a certain degree of pricing flexibility for its retail rates – pricing flexibility that is, however, carefully limited. First, the revenue impact of price increases is limited to 3% of intrastate regulated revenues in the first year and 3% in the second year of the Plan. Second, any increase in the charges for First Line Basic service shall not exceed \$1.85 per line in the first year and \$0.65 in the second year of the Plan. The Joint Proposal recognizes the fact that Verizon NY achieved dramatic improvement in service quality under the Performance Regulatory Plan ("PRP"), and that increased competition in the state would provide incentive for Verizon NY to continue these improvements. The Joint Proposal accordingly would implement a new service



quality plan “focused more on preserving past service quality gains.”<sup>6</sup> Finally, Verizon NY gained the right to adopt accounting practices more appropriate for the competitive environment in which it now operates.

**A. PRICING FLEXIBILITY IS APPROPRIATE**

In light of the robust competition in the current New York telecommunications marketplace, the pricing flexibility provided by the Joint Proposal is wholly appropriate and serves the public interest.

As Verizon NY and Staff demonstrated in their pre-filed testimony, pricing flexibility is an important and necessary part of a competitive market.<sup>7</sup> As Staff noted, once a market is open to competition, pricing flexibility allows rates to move gradually toward cost, creating more accurate pricing signals and allowing Verizon NY – and its competitors – to respond to market conditions and offer services that are more responsive to consumer needs.<sup>8</sup> Moreover, to the extent that Verizon NY is able to increase prices, this will have the positive effect of encouraging Verizon NY to invest in New York and of bringing the price in line with the cost of providing service – both of which are essential for a competitive marketplace. As both Verizon NY’s and Staff’s testimony shows, Verizon NY is given the opportunity under this Plan to earn a reasonable rate of return but by no means will it be able to earn at an excessive level.

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<sup>6</sup> Tr. at 141.

<sup>7</sup> See Panel Testimony of Verizon New York Inc. on the Verizon Incentive Plan for New York, dated February 11, 2002 (“Verizon Feb. Panel Testimony”), at 11-15; Staff Panel Testimony, dated February 11, 2002, at 8-10 and 55-62.

<sup>8</sup> Staff Panel Testimony at 9, 55-58.

Despite its acknowledgement of the important benefits to competition that will result from the Commission's UNE Rate Order and from Verizon NY's substantial concessions in the Joint Proposal,<sup>9</sup> the AG's statement expressed some concern about the pricing flexibility afforded Verizon NY under the Joint Proposal. In particular, the AG expressed concern that "Verizon NY is still the dominant provider of local services" and that, as a result, "the retail rate increases and pricing flexibility agreed to under the plan may permit Verizon NY a higher return than would otherwise be permitted a regulated monopoly telephone provider."<sup>10</sup>

These concerns are unfounded. First, the pricing flexibility under the Joint Proposal is carefully limited. As noted previously, any price increases are limited to 3% of intrastate regulated revenues in the first year and 3% in the second year of the Plan. In addition, any increase in the charges for First Line Basic service shall not exceed \$1.85 per line in the first year and \$0.65 in the second year of the Plan. Second, the AG fails to recognize that competition, particularly when heightened by the wholesale rate reductions and other provisions of the Joint Proposal, will limit Verizon NY's ability to sustain price increases. Moreover, the loss of revenue from the wholesale reductions in the Commission's UNE Rate Order, combined with the lowered forecasts for growth in the industry as a whole, pose significant challenges to Verizon NY's ability to earn a reasonable return in New York, notwithstanding the limited pricing flexibility the Plan

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<sup>9</sup> Tr. at 84.

<sup>10</sup> AG Comments at 20. At the hearing, Assemblyman Richard Brodsky's office raised a general concern about the pricing flexibility provisions of the Plan. While it is not clear whether that office is squarely opposed to those provisions, it is clear that it has not offered any legitimate reasons for modifying or rejecting them. Those provisions are appropriate (indeed, necessary) for all the reasons set forth in Verizon's Feb. Panel Testimony and in Staff's Panel Testimony as well.

provides. The AG's fear that Verizon NY could "over-earn" in this scenario is simply misplaced. In truth, pricing flexibility simply helps level the playing field to allow Verizon NY to compete. The limited pricing flexibility afforded to Verizon NY under the Joint Proposal is wholly justified.

The AG also expresses concern that consumers may be harmed by terminating the PRP on March 1, 2002, rather than on August 31, 2002. Among other things, the AG notes that the Joint Proposal would allow retail prices to increase during the period from March 1, 2002 to August 31, 2002, while they would have remained frozen under the PRP. The AG suggests that there was some guarantee of a seven-year term for the PRP. This is incorrect. The initial term of the PRP was five, not seven, years. Once Verizon NY extended the PRP, consumers received benefits of additional price reductions to which they were not necessarily entitled under the plain terms of the original PRP. Also, it must be noted that the market is far more competitive than when the PRP was adopted, and consumers have options they did not have before. If consumers choose not to pay these modest rate increases, they can – with ease – switch carriers. In addition, the continuation of the PRP may well have imposed additional costs on consumers. For example, the recent reduction in UNE rates would have been considered an exogenous cost and as such recoverable in current prices. In short, consumers have not been harmed.

## **B. THE SERVICE QUALITY PLAN IS SUFFICIENT TO PROTECT CONSUMERS**

The AG recommends a number of changes to the service quality provisions of the Plan.<sup>11</sup> For the reasons outlined below, each of the AG's recommended modifications should be rejected as unnecessary, unreasonable and excessively punitive.

### **1. Verizon NY Has Fulfilled the Purpose of the Performance Regulation Plan**

The AG correctly recognizes that “[o]ver the PRP years (September 1995 to present), Verizon NY made significant strides towards improving its service quality.”<sup>12</sup> However, in spite of that recognition, the AG recommends modifications to the service quality provisions of the Plan based on the premise that “Verizon NY has not fully improved its service to levels the PSC previously ordered so that New York customers receive ‘adequate’ telephone service ....”<sup>13</sup> This premise is flawed and there is no need to modify the Plan's service quality requirements since they are already “crafted in a manner that is most likely to ensure past improvements in service performance will be maintained.”<sup>14</sup>

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<sup>11</sup> At the hearing, Assemblyman Brodsky's office expressed concern over what it views as a possible “cutback on Verizon's service quality factors ....” (Tr. at 115-16.) That office made no specific criticisms of the service quality provisions in the Joint Proposal or recommendations concerning how, if at all, it believes they should be modified. While it is not entirely clear how or why that office believes Verizon NY's service quality standards have been “cutback,” it would seem this concern relates to the fact that the proposed Plan measures service quality in a more highly aggregated way than the PRP does. In its Feb. Panel Testimony, Verizon NY explained why this approach is reasonable given Verizon NY's service improvements over the past six years and the influence that competition will bring to bear on Verizon NY's service provisioning over the term of the new Plan. Thus, Assemblyman Brodsky's concern is unfounded.

<sup>12</sup> AG Comments at 9.

<sup>13</sup> *Id.* at 11.

<sup>14</sup> *Id.*

The AG first states that Verizon NY is “behind [Customer Trouble Report Rate (“CTRR”)] performance for 3 of 10 targeted central offices”<sup>15</sup> measured in the PRP. However, this is not current information. Verizon NY is currently meeting the Plan Year 7 CTRR targets in nine of the ten central offices targeted in the PRP. It needs to raise its current performance level in the Williamsburg central office by three tenths of one percent in order to achieve the Plan Year 7 CTRR target established for it. Verizon NY expects it would have achieved the Plan Year 7 CTRR targets in each of the targeted central offices if the PRP were to run its course.

It must be stressed, however, that current service quality levels in all ten targeted central offices would be considered more than “adequate” even if Verizon NY were to miss the Plan Year 7 CTRR targets in each. As Verizon NY explained in its May Panel Testimony, those CTRR targets represent CTRR levels that are vastly better than the CTRR levels that existed in those central offices at the time the PRP began.<sup>16</sup> More important, the Plan Year 7 levels are in all cases *more stringent* than the “Objective” level that other local exchange carriers are required to meet under the Part 603 service standards that are used in the PRP. Thus, while Verizon NY is now performing just short of the Plan Year 7 target in one of the ten targeted central offices, it is simply wrong to say that the current level of service there is not adequate.

The AG next observes that Verizon NY is “behind on Missed Repair Appointments (“MRA”) at 11 of 35 Installation and Maintenance Centers (“IMCs”),

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<sup>15</sup> *Id.* at 10.

<sup>16</sup> Initial Panel Testimony of Verizon New York Inc. on the Verizon Incentive Plan for New York, dated May 15, 2001 (“Verizon May Panel Testimony”), at 86-87.

[and] behind on Out of Service Over 24 Hours (“OOS>24”) at 13 of 35 IMCs ....”<sup>17</sup>

Here, too, the AG is wrong to suggest that existing levels of service in all IMCs is anything less than adequate. It should first be noted that Verizon NY’s service quality, as measured under the OOS>24 and MRA standards, is much improved over the levels at which Verizon NY had been performing when the PRP first began.<sup>18</sup> Staff made just this point in its testimony supporting the Joint Proposal where it concluded that the PRP “is judged to have succeeded”<sup>19</sup> despite the fact that Verizon NY did not achieve some of the performance targets set for the OOS>24 and MRA standards.

As Verizon NY explained in its May Panel Testimony, the fact that it may have missed some of the monthly and annual targets on these standards is of little significance in terms of Verizon NY’s overall performance under these standards.<sup>20</sup> This is because the PRP measures performance on the MRA and OOS>24 service standards in a highly disaggregated way that makes it likely that Verizon NY will miss one or more targets each year of that plan. It requires Verizon NY to meet 2 annual performance targets for each of 35 IMCs on these measures – for a total of 70 targets in each plan year – and 2 monthly performance targets for each of 35 IMCs – for a total of 840 targets in each plan year. The nature of the business itself (not to mention the law of averages) dictates that one or more IMCs will miss the monthly target in some months. These IMCs can easily miss the annual target where, as often happens, the one month miss substantially distorts

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<sup>17</sup> AG Comments at 10.

<sup>18</sup> See Verizon’s May Panel Testimony at 90-92; Exhibit Part C, Sections 7-9; Verizon Feb. Panel Testimony, Exhibit Part C, Schedules 6-8.

<sup>19</sup> Staff Panel Testimony at 36.

<sup>20</sup> Verizon May Panel Testimony at 90-92.

the annual average. Under the circumstances, it is incorrect to conclude that service quality in those IMCs is less than adequate.<sup>21</sup>

Finally, the AG cites the fact that Verizon NY missed the ultimate target in the CTRR Gap Closing Plan as further support for the claim this and the other “missed targets” mean that Verizon NY is not providing adequate service on some measures. This claim is inaccurate. Verizon NY missed the CTRR Gap Closing Plan target by *29/100 of one percent*. Its company-wide CTRR at the end of Plan Year 6 of the PRP was 2.78 troubles per 100 lines, service which by any measure can only be judged excellent. This was the lowest company-wide annual average CTRR that Verizon NY had ever achieved up to that point. Verizon NY’s company-wide CTRR level in the first five months of Plan Year 7 of the PRP is 2.31 troubles per 100 lines – a level that is better than the CTRR Gap Closing Plan target and, again, a level of excellent service. The AG’s claim that Verizon NY’s failure to achieve the CTRR Gap Closing Plan target resulted in a level of less than adequate service is simply wrong. To the extent that the AG’s recommended modifications to the service quality provisions of the Plan derive from an inappropriate definition of what service is “adequate,” these modifications should be rejected as unreasonable, if not draconian.

The CTRR Gap Closing Plan is instructive here only because it represents an unreasonable service plan that should not be repeated. That plan called for a total of \$75 million in penalties if Verizon NY failed to reach a level of service quality superior to any level it had ever achieved, even though Verizon NY nonetheless performed at a level

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<sup>21</sup> Moreover, as will be discussed in greater detail below, the Outliers component will protect against pockets of poor performance to the extent the AG is concerned that they might exist.

that can only be considered excellent. Such a plan is the wrong approach to regulating service quality, especially when service quality is well above adequate already and competition can be relied upon to ensure that Verizon NY will meet its customers needs and expectations for excellent service. The AG's recommendations, if adopted, would result in exactly that type of plan. They are regulatory anachronisms and they must be rejected.

**2. The Service Quality Plan Appropriately Measures Service Using Statewide Annual Averages**

The AG recommends that service quality relating to three of the Plan's Performance Objectives – CTRR, OOS>24, Installations Within 5 Days ("Installs w/in 5") – be measured at the Dispatch Resource Center ("DRC") level instead of the statewide level as proposed in the Plan. The AG asserts that "by aggregating the company's statewide performance for a whole year into a single average, good performance in some parts of the state could mask poor performance elsewhere."<sup>22</sup> The Commission should reject the AG's recommendations as unnecessary.

In its concern over the use of a statewide average, the AG ignores the impact of other aspects of the Plan. As Verizon NY explained in its Feb. Panel Testimony, the Plan will not permit poor service in any IMC (or other measured entity) to continue unabated since:

- (i) the Outliers Performance Objective will require Verizon NY to pay substantial penalties if it experiences more than 175 service inquiries in the first year of the Plan. Under the AG's scenario, Verizon NY would experience 204 service

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<sup>22</sup> AG Comments at 13.



inquiries on the OOS>24 service standard alone.<sup>23</sup> This would obviously cause Verizon NY to miss the Outliers Performance Objective and require it to pay at least \$15 million in penalties;

- (ii) the Outliers Performance Objective target of 125 service inquiries in the second and third years of the Plan will motivate Verizon NY to strive for continued good performance each month of each plan year. Any service inquiries which Verizon NY experiences in the last four months of the first and second years of the plan will roll over into the second and third years, respectively. If service in one-half of the IMCs were below the threshold level in those four months, it would be much more difficult (if not impossible) to achieve the more stringent performance target in plan years two and three. Thus, Verizon NY will need to avoid service inquiries at the end of each plan year to ensure that it is in the best possible situation at the beginning of the next one;
- (iii) the Outliers Performance Objective includes a provision that allows Verizon NY to receive credit in the form of additional “permissible” service inquiries in the second and third year of the Plan if it provides good service – defined as zero or one service inquiry on any one or more of the eight measures included in the Outliers component of the Plan – in the preceding year. However, the number of service inquiries that can be credited to the 125 service inquiries allowed in those years will be reduced, if not completely eliminated, if performance on any one of the eight measures included in the Outliers Performance Objective is poor.<sup>24</sup> If the scenario posited by the AG were to occur, Verizon NY would lose all credits it might otherwise have received for good performance on other measures. The proposed Plan will motivate Verizon NY to avoid that scenario; and

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<sup>23</sup> If one half of Verizon NY’s 35 IMCs – i.e., 17 IMCs – were to miss the performance threshold throughout the year – i.e., 12 months – Verizon would experience 204 – i.e., 17 times 12 – service inquiries that year.

<sup>24</sup> In any case where there are more than 50 service inquiries on one service quality measure, two points, or demerits, are deducted from the credits that can be added to the 125 allowed in the second and third years. In any case where there are more than two consecutive service inquiries in a measured entity, one-tenth of one point, or demerit, is deducted for each service inquiry over two.

- (iv) the PSC Complaint Performance Objective of the Plan would almost certainly be adversely affected by the type of service deterioration posited by the AG. Such a level of service would generate a huge upsurge in PSC complaints that could cause Verizon NY to miss the PSC Complaint Performance Objective. This miss, coupled with the missed Outliers Performance Objective, would require Verizon NY to pay \$40 million in penalties and would result in a suspension of Verizon NY's prospective pricing flexibility.<sup>25</sup>

The AG simply ignores these features of the Plan. These key components of the Plan provide more than adequate protection against the type of service quality issues about which the AG expresses concern. They provide compelling reasons to reject the AG's recommendation for a plan that would measure service at the DRC level.

There are other reasons to reject that recommendation. As Verizon NY explained in its Feb. Panel Testimony, Verizon NY's service improvements under the PRP have eliminated any need to measure service quality at the DRC level or any other, more highly disaggregated level.<sup>26</sup> Service quality is generally consistent in all areas of Verizon NY's service territory and measuring service on a statewide basis on four service standards sets the right level of regulatory oversight at a time when less, not more, regulatory oversight is warranted. The AG's proposed disaggregation would create greater administrative burdens that would hobble Verizon NY as it competes against CLECs that are not subject to any service quality plans or penalties.

Fundamentally, adopting the AG's recommendation would be inconsistent with the Commission's policy of allowing the forces of competition to help achieve service

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<sup>25</sup> Verizon Feb. Panel Testimony at 42-46.

<sup>26</sup> Verizon Feb. Panel Testimony at 40-41.

quality objectives. Recently, the Commission stated, “There is no evidence of a need to increase the regulatory burden of service providers, particularly when competition may provide consumers with benefits that increased regulatory requirements may preclude.”<sup>27</sup> Measuring performance on four service quality measures at the statewide level is perfectly in keeping with the Commission’s stated intention of reducing regulatory burdens associated with service quality measurement and reporting. Measuring such performance at the DRC level (as the AG recommends) would unnecessarily impede the Commission’s march towards streamlining regulation in this time of increasing competition.

### **3. The Performance Objective Targets Are Appropriate**

The AG recommends that the targets on the CTRR and PSC Complaint rate Performance Objectives be made more stringent. It points out that Verizon NY’s current company-wide CTRR is 2.17 troubles per 100 lines and recommends that the CTRR target in the Joint Proposal be modified from 3.3 to 2.25 troubles per 100 lines.<sup>28</sup> Similarly, the AG points out that Verizon NY’s current PSC Complaint rate is 0.387 complaints per 1,000 lines (or, 3.87 complaints per 10,000 lines) and recommends that the target in the Joint Proposal be modified from 5.5 complaints per 10,000 lines to a

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<sup>27</sup> Case 97-C-0139, “Memorandum and Resolution Adopting Revision of Parts 602, 603 and Section 644.2 of 16 NYCRR,” issued and effective October 6, 2000, at 5.

<sup>28</sup> The 2.17 company-wide CTRR level referred to by the AG is based on the revised Part 603 standards that will be used under the new Plan and apparently relates to the period from December 2000 through November 2001. This should not be confused with the 2.31 company-wide CTRR level that Verizon NY refers to herein as its current level of performance. That number relates to Verizon NY’s performance under the different CTRR standard used in the PRP. It is based on performance in the period of September 2001 through January 2002, or the first five months of Plan Year 7 of the PRP.

“lower” (but unspecified) level. The AG contends these modifications are necessary to protect against “backsliding.” They are not and they should be rejected.

In making these recommendations, the AG has perverted the concept of “backsliding” as applied in this Plan. As Verizon NY explained in its Feb. Panel Testimony, the targets set for the Performance Objectives in this Plan mark the boundary between acceptable and unacceptable service levels.<sup>29</sup> The Plan sets a level of service below which Verizon NY will face serious financial consequences (such as credits of up to \$170 million and suspension of prospective statewide pricing flexibility). These penalties more than adequately protect against backsliding to unacceptable levels.

The AG proposes that even a slight decrease in the current level of excellent service would be punishable backsliding. That is unreasonable. Fundamentally, such an approach would unfairly penalize Verizon NY for having achieved its current level of excellent service, even if a slight deviation from that performance would still provide an acceptable level of service.

The AG’s position is particularly unreasonable with respect to Verizon NY’s current CTRR level. Verizon NY achieved its current CTRR level due to a combination of factors, including its record-breaking capital investment in outside plant and infrastructure over the past six years. However, other factors, including a recent decline in demand for services and unusually good weather over the past year, have contributed to Verizon NY’s current level of extraordinary service under the CTRR measurement. These conditions cannot be counted on to last forever. However, a decline in the current CTRR levels that could occur would not mean that Verizon NY’s service quality was less

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<sup>29</sup> Verizon Feb. Panel Testimony at 35-37, 46-48.

than adequate, unless Verizon NY ultimately were to drop below the service floor established for the CTRR Performance Objective in the Plan.<sup>30</sup>

The same holds true with respect to the service floor established for the PSC Complaints Performance Objective in the Plan. Here, too, Verizon NY is currently performing well above that service floor. Its service should not be considered unacceptable if it falls below current performance levels and is instead at the performance threshold level, particularly since that performance threshold is only slightly below the level at which the Commission awards commendations for excellent service.<sup>31</sup>

The proposed more stringent targets by the AG are in conflict with the philosophy of the proposed Plan. The proposed Plan appropriately allows for a range of service quality above a reasonably acceptable level. In this way, it reflects the fact that competition has increased substantially over the course of the PRP and will increase further still over the course of the new Plan. Under the circumstances, the market must be allowed to set the level of service quality that competitors will be required to provide in order to avoid losing customers. By the same token, Verizon NY must not be forced to

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<sup>30</sup> The AG plays a numbers game in its example of how, “using the current retail line volume, the VIP threshold would permit customer repair requests to increase by 1,445,344 over the number for the most recent twelve-month period before any penalty would be imposed.” (AG Comments. at 13.) The AG pronounces this “unacceptable” in an attempt to co-opt the Plan’s stated premise of preventing “backsliding to unacceptable performance levels.” (Joint Proposal at 1.) If anything, the AG’s example provides proof of how much Verizon NY’s service quality has improved, not of how the Plan fails to protect against backsliding to unacceptable levels. Under the Plan, any level of service above the Performance Objective threshold is considered acceptable service. The mere fact that Verizon NY is currently performing well above the threshold level does not mean that it should be required to do so for the term of the Plan or that any level of service below the current level is poor. If the Commission were to adopt the AG’s proposed threshold of 2.25 troubles per 100 lines and Verizon NY’s CTRR at the end of the first plan year were 1.0 troubles per 100 lines, the AG would be hard pressed to argue that Verizon NY was providing unacceptable service if, in the following year, repair requests increased by 1.4 million and its CTRR was 2.25 troubles per 100 lines as a result.

<sup>31</sup> See Verizon Feb. Panel Testimony at 47.

provide a level of service that the Commission does not demand of Verizon NY's competitors and that the market may not demand itself. Setting performance objective targets at Verizon NY's current high levels of service would distort the economic signals of a well functioning market. It would impose undue regulatory burdens on one competitor to its disadvantage and, ultimately to the disadvantage of competition itself.

#### **4. The Plan's Proposed Penalty Amounts Are Appropriate**

The AG recommends "that the proposed VIP be modified to use graduated penalty amounts as the gap between actual results and the target widens."<sup>32</sup> While the AG does not propose any specific graduated penalty amounts or alternative penalty schemes, it contends that graduated penalties are necessary "to give the company a continuing incentive to do as well as it is able even if it becomes clear that a performance objective cannot be met in a given year."<sup>33</sup> The AG is wrong.

The Plan's total potential penalty amount – \$170 million per year – is, in Staff's words, "greater than the exposure that the company faced on the existing Performance Regulation Plan, which was roughly \$150 million per year."<sup>34</sup> While it is not entirely clear whether the AG is proposing that the total potential penalty amount be increased or, if so, by how much, the penalty amounts in the proposed Plan provide more than adequate incentive to maintain good service throughout the year.

Quite apart from the penalty amounts set in the proposed Plan, the service quality Performance Objectives are themselves designed to encourage Verizon NY to achieve the

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<sup>32</sup> AG Comments at 16.

<sup>33</sup> *Id.*

<sup>34</sup> Tr. at 143.

highest possible levels of service at all times. As explained in its Feb. Panel Testimony, Verizon NY will need to achieve the highest possible levels of service each month to avoid paying penalties based on its annual average and having its prospective statewide pricing flexibility suspended for a minimum of three months.<sup>35</sup> If service declines in any one month, Verizon NY will need to reverse that decline as a hedge against the possibility of future declines in later months that might cause it to perform below the required statewide annual average. Indeed, if a decline in any one month is severe, Verizon NY will need to raise its service levels considerably in subsequent months just to offset the effects of the service decline in the annual average. Since performance in the later months of a plan year will factor into the twelve-month rolling averages that will be reviewed quarterly in the second and third years of the plan, Verizon NY will need to continue to maintain high quality service throughout the year, even if its performance in the early months is sufficient to meet the yearly Performance Objectives.

Moreover, if Verizon NY found itself in the “penalty box” – that is, a minimum three-month period of suspended prospective pricing flexibility – abandoning efforts to improve service would only result in continued poor performance, thus inhibiting Verizon NY’s ability to get out of the penalty box. In such a situation, Verizon NY would not be able to pass all Performance Objectives for three consecutive months since the poor performance in the first plan year will be factored into the twelve-month rolling averages that will be reviewed in each of those three months.

For these reasons, the AG’s recommended graduated penalty scheme should be rejected. The proposed Plan already “give[s] the company a continuing incentive to do as

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<sup>35</sup> Verizon Feb. Panel Testimony at 48-51.

well as it is able....”<sup>36</sup> There is no need to modify it as the AG recommends, particularly since doing so would make a complicated plan far more difficult to manage.

**5. There Should Be No Separate Penalties  
for Individual Outliers**

The AG characterizes the Outliers Performance Objective as “probably the most important of the VIP’s service quality plan terms.”<sup>37</sup> It nonetheless contends that “[e]ven the 125 Outlier Performance Objective for the second and third VIP years could arguably permit deficient service in numerous reporting entities for an extended period before penalties are triggered.”<sup>38</sup> The AG, therefore, recommends that “the annual quota provision in the VIP be replaced with a \$100,000 penalty for each outlier.”<sup>39</sup> This recommendation, like the AG’s other recommendations, is unduly punitive and should be rejected.

Contrary to the AG’s claim, the existence of a single outlier does not signify a serious service failure that justifies a monetary penalty. As Verizon NY explained in its Feb. Panel Testimony, outliers (or, “service inquiries” as they are called in Part 603) occur in the normal course of any telephone company’s business and are often triggered by a series of unrelated events beyond the company’s ability to control.<sup>40</sup> As its very name implies, a “service inquiry” is one that requires investigation into the reasons for performance below a threshold level. Where one occurs, the company must identify and

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<sup>36</sup> AG Comments at 9.

<sup>37</sup> *Id.* at 17.

<sup>38</sup> *Id.*

<sup>39</sup> *Id.*

<sup>40</sup> Verizon Feb. Panel Testimony at 42-44.



take corrective actions. Service inquiries are mechanisms for flagging and immediately addressing potentially serious service failures. They were not conceived as a basis for imposing penalties of any amount, let alone a penalty of \$100,000 per each occurrence.

By setting a minimum number of “permissible” service inquiries, the proposed Plan allows for the fact that service inquiries are, to a large extent, unavoidable in a service area as large and as geographically and demographically diverse as Verizon NY’s service territory. To penalize Verizon NY for each service inquiry, as the AG recommends, would be unfair and unreasonable.

**6. Reviewing Service No Sooner Than The End of the First Plan Year Is Appropriate**

The AG recommends that the Commission review Verizon NY’s performance under the service quality provisions of the Plan and, if necessary, suspend Verizon NY’s pricing flexibility under the Plan at the six month anniversary of the adoption of the Plan “[t]o ensure that Verizon’s NY’s service quality performance is not ignored for the entire first year of the VIP.”<sup>41</sup> This recommendation should be rejected as unworkable and unnecessary.

The Plan calls for a review of service performance at the end of the first year and every three months thereafter. Each review is to be based on twelve months of performance, with the quarterly reviews to be based on a twelve-month rolling average of performance. Setting the first performance review at the end of the first year of the Plan is appropriate since Verizon NY is not now managing to the revised Part 603 service standards that will be used in this Plan. As Verizon NY explained in its Feb. Panel

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<sup>41</sup> AG Comments at 18.

Testimony, it is currently focused on the Part 603 standards that are measured under the existing PRP.<sup>42</sup> It will need to adjust certain of its management practices to account for the differences in those standards and the recently revised standards that will be measured under the new Plan once it is adopted. The AG's proposal to review service performance within six months of the Plan's adoption does not allow sufficient time for such adjustments. It would require Verizon NY to adapt to the revised service standards sooner than is appropriate.

Moreover, if Verizon NY's performance were to be reviewed six months after the Plan begins, the review would need to include a six-month period in which Verizon NY was not operating under the revised standards but was operating under standards included in the PRP. It would be unfair and unreasonable to hold Verizon NY to two different plans (with two different penalty schemes) for the same six months of service. The AG's recommendation would have just this effect and should be rejected.

Finally, there is absolutely no basis for the AG's claim that its recommended six-month review is necessary to ensure that "Verizon NY's service quality is not ignored for the entire first year of the VIP ...."<sup>43</sup> As described above and in Verizon's Feb. Panel Testimony, the proposed Plan already includes a panoply of features designed to ensure that Verizon NY does not ignore service quality for the first year of the Plan or at any time during the three year term of the service quality provisions.<sup>44</sup>

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<sup>42</sup> Verizon Feb. Panel Testimony at 44; *see also* Verizon May Panel Testimony at 117-18.

<sup>43</sup> AG Comments at 18.

<sup>44</sup> Verizon Feb. Panel Testimony at 42-46, 48-51.

**7. The Pricing Flexibility Link to Service Quality  
Should Not Be Modified**

The AG recommends that the service quality link to pricing flexibility be modified so that Verizon NY's prospective pricing flexibility is suspended if Verizon NY misses one, rather than two, Performance Objectives. The AG argues that "the standards proposed for many of the performance objectives are not sufficiently stringent and [ ] the monetary penalty risk is therefore relatively small ...."<sup>45</sup> This recommendation must be rejected for the same reasons the AG's recommendations for more stringent target levels must be rejected. The target levels are part of a carefully constructed plan that will ensure that service quality remains acceptable. It is designed to – and will – impose substantial penalties for a serious decline in service. The AG's proposed modification would unreasonably increase the penalty risk without appreciably improving any aspect of service. This recommendation must be rejected.

**C. THE TRANSITION TO GAAP ACCOUNTING IS APPROPRIATE**

In response to the increase in competition in the New York telecommunications market, the Joint Proposal requires Verizon NY to make the transition from regulatory accounting to Generally Accepted Accounting Principles ("GAAP") over a three-year period. As Staff and Verizon NY showed in their pre-filed testimony, this transition is appropriate and necessary, as it will allow Verizon NY to increase its depreciation and recover its plant investment costs in a fashion similar to its competitors.<sup>46</sup> Moreover, especially in light of the increase in competition that has developed in New York in

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<sup>45</sup> AG Comments at 18.

<sup>46</sup> See Staff Panel Testimony at 11-12; Verizon Feb. Panel Testimony at 20-24.

recent years and that will continue to develop in the future, three years (rather than the five years suggested by the AG) is an appropriate time frame to transition to GAAP accounting.

### **III. THE PLAN SHOULD BE VIEWED IN ITS ENTIRETY AND APPROVED AS SUBMITTED**

Most of the CLEC participants have offered unqualified support for the Joint Proposal, and nearly all parties at the hearing proclaimed their desire to see the Joint Proposal adopted with no changes, notwithstanding any concerns raised in their written comments. Nevertheless, we respond here to those few suggestions that the Commission tack on additional obligations on Verizon NY under the guise of approving the Joint Proposal. In some cases, as became clear at the hearing, the written comments were simply requests for clarification, which we also address below, in Section IV. To the extent requests for modification or for clarification inconsistent with the agreed-upon terms of the Joint Proposal remain under consideration, they should be rejected for the reasons set forth below.

#### **A. THE JOINT PROPOSAL DOES NOT BAR VERIZON NY FROM RECOVERING CERTAIN OSS COSTS**

Under the Joint Proposal, Verizon NY agreed not to seek recovery of certain OSS costs. In particular, Verizon NY agreed not to seek recovery of (1) the development costs, *i.e.*, the costs of modifying its systems and interfaces so that CLECs could obtain access to Verizon NY's OSS as identified in its previous exogenous filings; and (2) the costs identified in its January 9, 2002 filing (for OSS costs regarding line sharing, line splitting and subloop unbundling). Contrary to the suggestions of Bridgecom<sup>47</sup> and

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<sup>47</sup> Bridgecom International Statement in Support of Joint Proposal, dated February 12, 2002, at 8.